MINUTES
BOARD OF TRUSTEES OF THE
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 500
Indianapolis, Indiana 46204
September 16, 2005

REGULAR SESSION

Board Members Present
Ken Cochran, Chair
Chuck Schalliol, Vice Chair
Kathy Ettensohn
Matt Murphy
Bob Welch
Regina Overton

Board Members Absent
None

Others Present
Tony Armstrong, Office of Management & Budget
Doug Todd, McCready & Keene
Richard Lenar, McCready & Keene
Scott Nickerson, Crowe Chizek
Mary Rankin, State Board of Accounts
Deborah Lynn Gibson, State Board of Accounts
Doug Kryscio, Mercer Investment Consulting
Iliana Nikolova, Mercer Investment Consulting
Curt Smith, Strategic Investment Solutions, Inc.
Peter Kelioutis, Strategic Investment Solutions, Inc.

PERF Staff Present
David Adams, Executive Director
Bruce Fink, Chief Investment Officer
Charles Johnson, Chief Financial Officer
Linda Villegas, Staff Attorney
Jayelynn Willman, Executive Assistant to the Board
Donovan Cartwright, Director of Benefits
Clay Jackson, Chief Internal Auditor

Meeting called to order at 12:10pm by Chairman Cochran.

I. Approval of Minutes

MOTION duly made and carried to approve the minutes from the July 15, 2005 board meeting.

Proposed by:	***Chuck Schalliol***
Seconded by:	***Matt Murphy***
Votes:	***6 in favor, 0 opposed, 0 abstentions***

II. Board Fiduciary Liability Discussion

At the previous board meeting, fiduciary liability insurance was discussed by Linda Villegas with the board. Ms. Villegas stated that the structure of the coverage would require coverage of the board as well as the staff of the fund. Ms. Villegas also discussed that the insurance coverage covers much of what is already covered by the Indiana Tort Claims Act.

Ms. Villegas noted that she did not find any cases filed in Indiana regarding fiduciary liability and the PERF Board. Ms. Villegas indicated that the Indiana Tort Claims Act really provides very good coverage and protection for state agencies. In 2000, PERF and TRF, as quasi-governmental agencies, had outside counsel determine if the Indiana Tort Claims Act covers PERF and TRF. Outside counsel stated that these agencies are covered. Ms. Villegas also stated that TRF had previously reviewed the Indiana Tort Claims Act and did not determine a need for additional fiduciary liability insurance.

Ms. Villegas stated that to obtain a quote for coverage, an application would need to be completed and in-depth interviews would need to be conducted with key members of the PERF staff.

Chairman Cochran stated that this issue will be put on the next agenda to give the board members time to review the information provided by Ms. Villegas.

III. Investments

David Adams provided an overview to the board outlining the six funds administered by PERF, their funding ratio and how they are funded. Three of the plans are appropriated by the General Assembly and three are actuarially funded. The National Association of State Retirement Administrators (NASRA) published the results of a public pension fund survey and found that on average, public funds are 87.7% funded. The PERF fund, which is the largest fund, is above that rate. The survey also indicated that greater than 70% of the plans have an actuarial rate of return of 8% or higher and less than 10% of the plans have a rate of 7.25% or lower. The PERF plan has an actuarial rate of return of 7.25%. Mr. Adams discussed that the PERF plan has a high funding ratio and a relatively conservative rate of return, both good indicators for the plan.

Mr. Adams further reviewed the investment policy, especially around the allocation of alternative investments, and various types of investment consultants. He discussed a 'go it alone', 'fund of funds' and 'gatekeeper' strategy and a hybrid of all three.   Mr. Adams indicated that SIS is under contract and is a 'gatekeeper' type of consultant and Mercer is under contract as a general investment consultant to the plan.

Kathy Ettensohn asked about the responsibilities of Mercer and SIS. Mr. Adams responded that Mercer, as our general consultant, will advise the investment staff and the board on matters that pertain to the entire fund such as allocation strategy, asset/liability modeling, manager evaluation, selection and monitoring and SIS focuses on alternative investments for the fund.

Chuck Schalliol asked what we pay our consultants. Mr. Adams stated that SIS is paid approximately $210,000 a year and Mercer is paid $225,000 a year.

Ms. Ettensohn inquired about the status of the RFI selection for the Russell 1000 Index provider.   Mr. Adams explained that we have received all of the responses, an evaluation team has been assembled to review the responses, and a decision is planned within the next 45 days.

Investment Update

Bruce Fink reviewed the investment performance for the 12 months ending August 31, 2005. Mr. Fink stated that CRIF assets are approximately $12.8 billion and all asset classes, for the time periods covered by this report, are doing very well relative to both their benchmark and on an absolute basis. Mr. Fink indicated that mid cap equity exposure has been improving over the last few quarters, but is still underperforming its benchmark although the absolute return at 20% for the year is still a very attractive return.

Recommendation of Alternative Investment Opportunities

Mr. Fink introduced SIS and indicated that he would have SIS present two alternative investment opportunities for review by the board: The first is Oaktree Capital (OCM) Opportunity Fund VI and is a proposed

$30 million investment. The second investment, Lexington Capital Partners VI., is a proposed $50 million dollar commitment.

Mr. Fink stated that the current target allocation to the alternatives program is 5% of the CRIF assets. Assuming CRIF assets of $12.5 billion this represents $625 million. Mr. Fink stated that within the 5%, the investment policy outlines sub-asset classes such as buy out, venture capital, debt related, etc. Mr. Fink discussed with the board that the current program commitment is approximately $115,960,000, leaving an uncommitted balance of approximately $509 million. Mr. Fink discussed how the two deals being proposed fit into the sub asset classes. Mr. Fink indicated that one of the opportunities was a secondary fund and the other a distressed debt fund.

Curt Smith, SIS, explained the details of the OCM opportunity. Mr. Smith stated that Oaktree is a well known fund and has a successful track record. Mr. Smith stated that this fund is closing in two weeks and there was only a small amount of the fund made available to new investors.

Matt Murphy asked Mr. Smith to discuss the management fees involved with this deal. Mr. Smith explained that the management fee is based on commitments and in Oaktree's case, below the standard in private equity.

Bob Welch asked why the fund being raised is reduced by nearly a third from the last fund. Mr. Smith indicated that Oaktree determines the market opportunity when sizing a fund. Mr. Smith stated that controlling the fund's size is to the credit of Oaktree.

Mr. Welch noted that a principal member of Oaktree had recently left the firm and inquired as to this events affect on the Board's decision. Mr. Smith indicated that the current manager had a family matter to attend to and that there are other individuals who can take his place during his leave. The individual will remain available to Oaktree on a consulting basis.

Mr. Welch asked SIS if they knew how many of the previous investors are participating in this fund. Mr. Smith indicated that almost all of the current investors were interested in re-upping.

Mr. Smith discussed the details of the Lexington Capital Partners VI recommendation and indicated that the management fee is low relative to other direct funds. He indicated there is no preferred return on this fund and that is why there is a lower management fee.

Mr. Fink indicated that projected investments by Lexington align closely with PERF's sub asset classes in the alternatives program: 45% buy out, 20% venture, 5% debt and 30% international. Mr. Fink discussed that PERF does not currently have any dedicated international alternative asset exposure.

Mr. Schalliol noted that this is the first time this board has looked at these particular kinds of investments. Mr. Schalliol noted that the hiring goal of the consultant, the investments team and in the future, a director of alternative investments, is to figure out ways for us to participate in these inefficient markets. Mr. Schalliol stated that the board could wait until the director of alternative investments to be hired and that this should be considered. He stated that the priority of the fund is to protect the capital for our retirees, but if better returns can be achieved while doing that, that's great. He further stated that he continues to have an interest in seeing us making these investments in Indiana as well as women and minority firms.

Mr. Adams stated that PERF continues to evaluate and recruit candidates for the director of alternative investments. He stated that this individual will help build the overall strategy for the alternative investments. Mr. Adams stated that both of the opportunities being proposed fit into the current allocation strategy. He discussed that the objective of presenting these opportunities was to allow the board to review two opportunities currently being proposed by our consultants. If the board moves forward with these two deals, there is still a significant amount of dollars to be invested.

Chairman Cochran expressed concerns regarding moving forward until additional staff are hired and a strategy is in place. He further stated that he would like to see additional opportunities created for Indiana.

Mr. Murphy stated that the comments are valid and board education is a component as well. Mr. Murphy indicated that the current investment policy states a 5% allocation and moving towards that in the most prudent manner is important as well.

MOTION duly made and carried to accept the recommendations of the investment staff and SIS for alternative investments in Oaktree Capital Opportunity Fund VI of $30 million and in Lexington Capital Partners VI of $50 million.

Proposed by: ***Kathy Ettensohn***
Seconded by: ***Matt Murphy***
Votes: ***4 in favor, 1 opposed, 1 abstention***

Regina Overton explained that she believes that alternative investments are a good idea, but given this is her first board meeting will defer this decision to other board members and abstain from this vote.

Ms. Ettensohn stated that she completely agreed with the comments of having a director of alternative investments to assist with the development of strategy. She then asked Mr. Smith if PERF could direct or advise a fund regarding investments in Indiana. Mr. Smith explained that you can encourage them to invest where you want them.

Mercer Presentation

Bruce Fink introduced Doug Kryscio and Iliana Nikolova from Mercer, the General Consultant for PERF.

Ms. Nikolova gave the board background information on Mercer and its parent company Marsh & McLennan Companies. The primary team at Mercer for Indiana PERF is Ms. Nikolova, Mr. Kryscio and Lewis Finney, who is Mercer's Chief Resident Phd. Economist.

Ms. Nikolova then gave an overview of the PERF fund. She explained that the fund was entirely invested in fixed income securities through the latter part of 1996. With the Equity Referendum of 1996, the fund was allowed to invest in equity as well as other asset classes. In the beginning of 1997, PERF made its first initial investment into the S&P 500 Index Fund.

Mr. Kryscio explained that Mercer's role is to: assist PERF investment staff and the board, monitor investment managers, assist with manager selection, and help with investment policy development and review of that policy for the board.

Mr. Kryscio discussed the NASRA survey and pointed out that of 27 public fund plans in the survey, the average funding status is 87.8%, which is down from 91.2% funded in 2003. The latest from PERF, which was included in that study, was 102.9%. Only 71% of the plans are greater than 80% funded according to that survey. They anticipate about 80-85% of all public funds were calculated in that survey.

Mr. Adams asked how Mercer would rate PERF based on the current allocation strategy, the current funding, and actuarial rate of return
M r. Kryscio expressed that we are in good shape.

IV. **Audit & Budget**

Financial Update

Charles Johnson informed the board that for the first time a consolidated picture of PERF's financial statements was included in the board books. PERF has total net assets of approximately $13.4 billion dollars.

Mrs. Ettensohn noted there was an increase in accounts payable of $2 million from the prior year and asked if this was a timing issue. Mr. Johnson responded affirmatively and explained that PERF had a lot of obligations from the end of this June and wanted to accurately reflect payables.

Mr. Johnson also informed the board that the Governor has asked all executive branch agencies to reserve 7% of their budget and has asked PERF to voluntarily comply with that. Mr. Johnson will present to the board at the next meeting where he thinks those reductions will come from.

<u>SBOA</u>

Mr. Adams indicated that the planned end date for the audit is October 28th, that this would be a record for PERF and would be nearly 6 months quicker than last years audit. Mr. Adams indicated that Scott Nickerson from Crowe Chizek, who is acting as a liaison between PERF and the SBOA, will also be providing an update.

Mr. Johnson introduced Deborah Lynn Gibson and Mary Rankin from the State Board of Accounts to discuss the audit they are conducting on PERF.

Ms. Gibson explained the three prong approach that is being used for the PERF audit. It consists of the financial statement audit, the statewide financial statements which PERF is included in, and then compliance auditing.

Ms. Rankin explained that management is responsible for compiling the financial statements, performing reconciliations, writing notes to financials and providing those for audit.

Ms. Rankin went over the accounting matters that she thought the board should know about. This year will be the initial year of implementation of Governmental Accounting Standards, Statement Number 40, Deposit and Investment Risk Disclosure. The statement changes what was in last's years financial statement note on the custodial credit risk disclosure (Note 5). It lessens that disclosure, but adds disclosures required for equities, deposit and investment risks, related credit risks for debt securities, concentrations of credit risk, interest rate risk and foreign current risk. Overall it will expand the note disclosure. Ms. Rankin indicated that PERF has a team to compile the note and disclose it for audit.

Another major accounting matter will be to follow up on the status of the accounting for the reserves. Ms Rankin stated that the reserves have not been disclosed for two fiscal years and have resulted in a qualification of the financial statements for the last two years. Ms. Rankin indicated that the exit conference invitees are the Executive Director, the Chairman of the Board and additional members management believes should be at the conference. Ms Rankin stated that the purpose of the conference is to review the audit findings. Ms. Rankin indicated that if the audit ends in October the exit conference would be in November.

Crowe Chizek

Scott Nickerson outlined some of the project management roles that they are involved including being the audit liaison, and some of the product management tools that are used to coordinate the efforts to help in the audit process.

Mr. Schalliol expressed concern regarding the costs of Crowe providing assistance for this audit. Mr. Adams discussed that one of the significant concerns from the auditors' standpoint last year was PERF's ability to properly conduct an audit, both from a timing and resource standpoint. Mr. Nickerson committed to make sure these audits processes are documented so that once Crowe is prepared to leave; PERF staff is prepared to take on the auditing role.

Internal Auditing

Clay Jackson, PERF's Internal Auditor, provided the board background on his group, work experience and qualifications. Mr. Jackson reviewed the planned audits for FY06.

V. **Benefits**

Line of Duty Death Benefit

Mr. Adams discussed the one Line of Duty Death Benefit that was paid since the last board meeting. He discussed the circumstances surrounding Ronald Ward, a state employee who lost his life in the line of duty. A benefit of $50,000 was approved for Mr. Ward's family on July 20, 2005. It was previously taking 90 days to process one of these claims. With the changes that the board made to the policy surrounding these benefits, PERF can much more quickly pay these benefits.

Benefits Update

Mr. Adams introduced Donovan Cartwright, Director of Benefits, to the Board of Trustees.

Mr. Cartwright provided the board with some background information and some of the projects currently going on within PERF.

Mrs. Ettensohn inquired about whether or not PERF has an incentive plan for members of staff who were performing well. Mr. Adams stated that a performance management plan is slated for January 2006. Mr. Adams stated that PERF is in the process of hiring a human resources director to manage this process.

Mr. Adams informed the board that individual teams are being recognized on a monthly basis as a result of achievements on the Scorecard.

Executive Director Report

Mr. Adams reviewed the most recent Scorecard with the Board. In less than six months, PERF has achieved more than $1M in recurring savings and a one time savings in excess of $150K.   Areas that performed well last month were the investments team and new member enrollments   Mr. Adams indicated that an additional measure, 'time to first retirement check', would be on the scorecard as this is what future retirees are most concerned about.

In order to improve this measurement, a checklist to be included with the retirement application is now being included in every retirement application, Mr. Adams stated.

Mr. Adams also illustrated and explained a new 'Bridge to Retirement' brochure and how it will help members understand the retirement process. He indicated that PERF customers do not know what to expect from PERF. PERF historically has done a poor job educating its members and it is his goal to make this part of the fabric of the organization. The brochure will go to all employers and all members in their quarterly statements. Mr. Adams stated that the training organization will become much more focused on assisting future retirees with planning their retirement versus processing a retirement.

Mr. Adams discussed the Pension Management Oversight Committee (PMOC) that meets each Fall and submits a report to the General Assembly by November 1. Mr. Adams provided a copy of the committees' charter from their web site to each board member.

Mr. Adams spoke about the hiring of Jeffry Carter as our Director of External Affairs and gave brief information on his background.

Mr. Adams indicated that additional staffing is being sought through supplemental employment contracts. Each contract employee undergoes the same screening and background checks as full time employees.

Mr. Adams stated that a preliminary disaster recovery program has been created. A detailed plan did not previously exist. Mr. Adams indicated that PERF is planning to contract with a third party to put a strategic plan in place.

Mr. Adams also indicated that his team had uncovered 12 million + documents that had not been previously archived according to state retention requirements A plan has been developed and is being implemented to start this process.

Mr. Adams also discussed that given the amount of paper within PERF, additional security measures have been implemented. A third party firm is also being consulted to look at reviewing all of PERF's operations to insure appropriate levels of security.

VI. **Date of Next Meeting**

Set for November 16, 2005 at Noon.

VII. **Adjournment**

Meeting adjourned at 4:10pm.